Hastings Law Journal

Volume 24 | Issue 2 Article 7

1-1973

Personal Injury Damages and Inheritance and Gift Taxes--Revenue and Taxation Code Section 13560

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PERSONAL INJURY DAMAGES AND INHERITANCE AND GIFT TAXES—REVENUE AND TAXATION CODE SECTION 13560

Imputed contributory negligence has long been criticized.[1] However, the California legislature's attempts to slay this hydra-headed monster have served to confuse the characterization of personal injury recoveries as separate or community property. Prior to 1957, such recoveries were community property, absent any contrary agreement between spouses.[2] Thus, when a spouse was contributorily negligent, the other spouse was denied recovery for injuries resulting from the negligence of a third person.[3] In 1957, the legislature attempted to abrogate this harsh result. California Civil Code section 163.5 was enacted making "damages . . . awarded" for personal injuries the separate property of the injured spouse.[4] This legislation was sharply criticized as creating more problems than it solved.[5] Therefore, in 1968, it was amended. Once again personal injury damages were classified as community property except when paid by one spouse to the other.[6]

This 1968 amendment does not alleviate all problems. The wording of the former section 163.5 created confusion and remains a troublesome area of the law. This is demonstrated by a recent court of appeals case of first impression. *Estate of Rogers*[7] held that a compromise settlement is essentially the same as an "award" and therefore

1. *E.g.*, W. PROSSER, HANDBOOK OF THE LAW OF TORTS 488 (4th ed. 1971); James, *Imputed Contributory Negligence*, 14 LA. L. REV. 340 (1954); Keeton, *Imputed Contributory Negligence*, 13 TEXAS L. REV. 161 (1935).

2. *See, e.g.*, Zaragosa v. Craven, 33 Cal. 2d 315, 321, 202 P.2d 73, 78 (1949).

3. See notes 31-34 and accompanying text *infra*.

4. CAL. STAT. 1957, ch. 2334, § 1, at 4065 (amended 1968, repealed 1969). In 1957 former California Civil Code section 163.5 read "[a]ll damages, special and general, awarded a married person in a civil action for personal injuries, are the separate property of such married person." This statute was amended by Cal. Stat. 1968, ch. 457, § 2, at 1078 to read "[a]ll money or other property paid by or on behalf of a married person to his spouse in satisfaction of a judgment for damages for personal injuries to the spouse or pursuant to an agreement for the settlement or compromise of a claim for such damages is the separate property of the injured spouse." The 1968 version was added to the Family Law Act of 1970 by Cal. Stat. 1969, ch. 1608, § 8, at 3338 and is now codified at CAL. CIV. CODE § 5109 (West 1970).

5. See notes 55 & 60 *infra*.

6. *See* Cal. Stat. 1968, ch. 457, § 2, at 1078 (repealed 1969) at note 4 *supra*.

7. 24 Cal. App. 3d 69, 100 Cal. Rptr. 735 (1972).

must be characterized as separate property. *Rogers* is also the first case to construe Revenue and Taxation Code section 13560. This section provides that community property having its origin in the separate property of one spouse shall be treated, for inheritance tax purposes, as separate property.[8] The holding in the *Rogers* case will have far reaching effects because compromise settlements are common and former Civil Code section 163.5 still governs personal injury recoveries received between 1957 and 1968 when it was in effect.

This note will examine the court's classification of settlements as separate property and the resulting gift and inheritance tax consequences. The legislative intent of both former Civil Code section 163.5 and Revenue and Taxation Code section 13560 will be analyzed. A discussion of the constitutional validity of that inheritance tax statute as applied in *Rogers* will follow. When the statutes are read together, the result of *Rogers* is unjust and possibly unconstitutional. This note will show that some form of relief, legislative or judicial, must be forthcoming.

Background of the Rogers Case

In 1963, Mr. Rogers was severely injured while working as a welder in the boiler of a ship. The injury was caused by the negligence of one of the shipowner's employees. Mr. Rogers was not contributorily negligent which would have barred his recovery.[9] Through his wife acting as guardian ad litem, he brought suit against the shipowner, Southern States Navigation Corporation.[10] The case was set-

8. CAL. REV. & TAX CODE § 13560 (West 1970) provides that "[i]f one spouse makes a gift of an interest in separate property to the other and the interest so given, together with an equal interest retained by the donor, becomes their community property, such equal interests shall be treated as held by them as their separate property, and not as community property, for the purposes of this part." CAL. REV. & TAX CODE § 15310 (West 1970), enacted as a companion to CAL. REV. & TAX CODE § 13560, provides identical treatment for gift tax purposes.

9. Opening Brief for Appellants at 2, Estate of Rogers, 24 Cal. App. 3d 69, 100 Cal. Rptr. 735 (1972). The accident occurred when an employee of the Southern States Navigation Corporation, owner of the ship, turned a full head of steam into the boiler where Mr. Rogers was working. For a period of nearly two years after the accident Mr. Rogers was confined to hospitals and remained under the care of physicians until his death from a heart attack in 1969. Respondents, The State of California and Houston Flournoy, Controller, contended that the absence of contributory negligence on the part of Mr. Rogers had no relevance to the issues. Brief for Respondents at 6, 7. This contention appears fallacious when one considers the legislative intent of former Civil Code section 163.5. This statute was concerned with imputed contributory negligence and the absence of such in this situation therefore contravenes the intent of the legislation. See note 56 and accompanying text *infra*.

10. Opening Brief for Appellants at 4, Estate of Rogers, 24 Cal. App. 3d 69, 100 Cal. Rptr. 735 (1972). The original complaint was filed June 12, 1963, in the

tled before trial, and Mr. Rogers received $265,667 in full settlement for all claims.[11] From the date of the accident until his death, neither he nor his wife worked for wages.[12] The compromise settlement was treated as community property. For the Rogers, the recovery was in reality a substitute for income. All living expenses, medical bills and taxes were paid from this sum.[13] When Mr. Rogers died in 1969 he left his entire estate to his wife.[14]

Upon his death, California levied a gift tax[15] as well as an inheritance tax.[16] These tax liabilities arose from the compromise settlement only; other community property owned by the Rogers was not in dispute.[17] Mrs. Rogers filed two actions which were consolidated for trial. One was her Objections to Report of Inheritance Tax Appraiser.[18] The report was upheld.[19] The other action was to recover the gift tax paid,[20] which was denied.[21] On appeal both decisions were affirmed.[22]

Rogers raised three basic issues which will be considered in detail. The first was whether compromise settlements should be char-

Superior Court for the City and County of San Francisco and later removed to the United States District Court for the Northern District of California.

11. *Id.* at 5.

12. *Id.* at 2. The only source of income prior to the accident was the earnings of both Mr. and Mrs. Rogers. After the accident Mrs. Rogers did not work, spending most of her time attending the needs of her husband.

13. *Id.* at 5.

14. Opening Brief for Appellants at 7.

15. Brief for Respondents at 39. The Controller, in computing the gift tax, allowed for medical expenses, living expenses and certain other expenses and found that there was about $235,000 traceable to the compromise settlement. Gift tax was levied on one-half of this amount, or $117,500, this sum representing the gift of separate property that Mr. Rogers had transmuted to community property. Tax was levied as of the date of the settlement, June 1, 1964, plus interest and penalty for late filing. The amount of gift tax was $5,850.73. *Id.* at 4. The court in *Rogers* determined the amount upon which gift tax was levied to be $113,500. Estate of Rogers, 24 Cal. App. 3d 69, 72, 100 Cal. Rptr. 735, 736 (1972). The discrepancy in the two figures resulted from adjustments made in the course of negotiations between the parties.

16. Opening Brief for Appellant at 8. The Controller held that $207,590.54 was the amount of assets held by Mr. Rogers at the time of his death. From this amount, deductions were made for a marital exclusion ($49,410.19), a Revenue and Taxation Code section 13560 exclusion ($98,820.61) and certain other exclusions amounting to $14,979.92. The amount upon which the inheritance tax of $2,664.61 was levied was $44,410.19. Record, Statement of Stipulation at 33.

17. Opening Brief for Appellants at 6.

18. *Id.* at 8.

19. Brief for Respondents at 5.

20. Opening Brief for Appellants at 8.

21. Brief for Respondents at 5.

22. Estate of Rogers, 24 Cal. App. 3d 69, 100 Cal. Rptr. 735 (1972).

acterized as separate or community property under the language of former Civil Code section 163.5 which refers only to "damages . . . awarded."[23] If the settlement were held to be community property, it then would be exempt from inheritance tax under Revenue and Taxation Code section 13551.[24] The second issue concerned whether or not Revenue and Taxation Code section 13560, which would impose an inheritance tax on community property that had been transmuted from separate property, should be applied in this case. The third issue was whether Revenue and Taxation Code section 13560 as applied in situations such as *Rogers* is unconstitutional as a denial of equal protection.[25]

Property Classification of Personal Injury Damages

The Law Prior to Civil Code Section 163.5

Under California community property law, all property owned by either husband[26] or wife[27] before marriage and "that acquired afterwards by gift, bequest, devise, or descent . . ." is the separate property of that spouse.[28] All other property acquired during the marriage falls into the community property category.[29] Therefore, prior to 1957, the cause of action and the damages recovered for personal injuries were classified as community property.[30] This classification led courts to deny recovery to an injured spouse if the other spouse were contributorily negligent.[31] The denial was based on the theory that because the recovery was community property the guilty spouse would profit from his or her own wrong.[32] This result was criticized by legal

23. Cal. Stat. 1957, ch. 2334, § 1, at 4065 (amended 1968, repealed 1969). See note 4 *supra.*

24. CAL. REV. & TAX CODE § 13551 (West 1970) provides that "[u]pon the death of a spouse: (a) None of the community property transferred to a spouse is subject to this part [inheritance tax], except as provided in Section 13694 [power of appointment] . . . ."

25. See text accompanying notes 86-99 *infra.*

26. Cal. Stat. 1850, ch. 103, § 1, at 254 now codified at CAL. CIV. CODE § 5108 (West 1970).

27. CAL. CONST. art. XI, § 14 (1849) now codified at CAL. CIV. CODE § 5107 (West 1970).

28. *Id.;* Cal. Stat. 1850, ch. 103, § 1, at 254 now codified at CAL. CIV. CODE § 5108 (West 1970).

29. Cal. Stat. 1850, ch. 103, § 2, at 254 now codified at CAL. CIV. CODE § 5110 (West 1970).

30. McFadden v. Santa Ana O. & T. St. Ry., 87 Cal. 464, 25 P. 681 (1891). *See* Schecter v. Superior Court, 49 Cal. 2d 3, 314 P.2d 10 (1957); Kesler v. Pabst, 43 Cal. 2d 254, 273 P.2d 257 (1954).

31. *E.g.,* Zaragosa v. Craven, 33 Cal. 2d 315, 202 P.2d 73 (1949); McFadden v. Santa Ana O. & T. St. Ry., 87 Cal. 464, 25 P. 681 (1891).

32. Flores v. Brown, 39 Cal. 2d 622, 630, 248 P.2d 922, 926 (1952). "In the

writers[33] and some members of the judiciary.[34] Legislative efforts were made in response to this criticism. For example, in 1951, former Civil Code section 171(c) was enacted.[35] It provided:

> [The] wife has the management, control and disposition, other than testamentary except as otherwise permitted by law, of community property money earned by her, or community property money damages received by her for personal injuries suffered by her, until it is commingled with other community property, except that the husband shall have management, control and disposition of such money damages to the extent necessary to pay for expenses incurred by reason of the wife's personal injuries.[36]

Although this statute gave the wife management and control of her personal injury recoveries, it did little to change the operation of the imputed contributory negligence rule.[37]

In order to avoid denying recovery, the courts softened the application of the rule in some cases. For example, a wife was allowed to recover when her husband died in an accident and thus could not benefit by his wrongdoing.[38] In *Washington v. Washington*,[39] the

absence of an agreement to the contrary, it is settled that a cause of action for injuries to either the husband or the wife arising during the marriage and while they are living together is community property. . . . Accordingly, in all of these situations it is ordinarily necessary to impute the negligence of one spouse to the other to prevent the negligent spouse from profiting by his own wrong."

33. See note 1 *supra*. The imputation of contributory negligence of one spouse to another had its origin in the legal identity of the wife with her husband at common law. Each was charged with the negligence of the other. The Married Women's Acts have terminated this identity and negligence is no longer imputed on the basis of the marriage relationship alone. The exception to this is the community property states that treat personal injury damages as community property and impute contributory negligence to the spouse to prevent unjust enrichment. See W. PROSSER, HANDBOOK OF THE LAW OF TORTS 489-90 (4th ed. 1971).

34. *E.g.*, Zaragosa v. Craven, 33 Cal. 2d 315, 322, 202 P.2d 73, 77 (1949) (dissenting opinion).

35. Cal. Stat. 1951, ch. 1102, § 1, at 2860.

36. *Id.*

37. *See* Cal. Stat. 1951, ch. 1102, § 1, at 2861 which also stated that "[t]his section shall not be construed as making such money the separate property of the wife, nor as changing the respective interests of the husband and wife in such money. . . ." See 2 B. ARMSTRONG, CALIFORNIA FAMILY LAW 1512 (1953): "It would not seem that C. C. 171(c) . . . would alter the *Zaragosa* rule that contributory negligence bars the wife's recovery. The damages collected by the wife still are community property by the terms of the section and the husband has a vested one-half interest therein." 4 B. WITKIN, SUMMARY OF CALIFORNIA LAW 2711 (7th ed. 1960) states that "[n]o authoritative determination of the effect of the new statute on the imputed negligence rule was made."

38. Flores v. Brown, 39 Cal. 2d 622, 248 P.2d 922 (1952).

39. 47 Cal. 2d 249, 302 P.2d 569 (1956). Justice Carter, in his concurring opinion stated that "[t]he majority opinion, however illogical in the light of the Zaragosa case, is a small step in the right direction." *Id.* at 257, 302 P.2d at 573. The majority did not directly overrule *Zaragosa*, however. Much the same reasoning was

parties were divorced before final judgment. The court held that the cause of action vested in the injured spouse. Still another case held that if the parties were domiciled outside California in a non-community property jurisdiction, there was no reason for the husband's contributory negligence to bar the wife's recovery.[40]

Even though the courts did allow these few exceptions, attempts to circumvent imputed contributory negligence by post-injury property agreements between husband and wife were ineffective. The accrued cause of action would become the separate property of the injured spouse by the contributorily negligent spouse's agreeing to relinquish his interest. Theoretically, since he had no interest in the property, he could not profit by his wrong. In *Kesler v. Pabst,*[41] however, this was rejected. The court held that by giving up his interest in the cause of action, the husband was relinquishing a major property right and that this was a benefit to him.[42]

Enactment of Former Civil Code Section 163.5

These attempts to avoid the rigors of the imputed contributory negligence rule demonstrated that legislative action was imperative.[43] Two proposed remedies were before the legislature in 1957.[44] The first attacked the problem in a straightforward manner, providing that "[t]he negligence or contributory negligence of one spouse shall not be imputed to the other spouse to deny recovery to such spouse in any

used in Foote v. Foote, 170 Cal. App. 2d 435, 339 P.2d 188 (1959) where the parties were married after the accident.

40. Bruton v. Villoria, 138 Cal. App. 2d 642, 292 P.2d 638 (1956). One writer labels these exceptions as "illogical." 1 CALIFORNIA FAMILY LAWYER 113 (Cal. Cont. Educ. Bar 1961). It would appear that these distinctions are technical ones that the court has used to give relief from the imputed contributory negligence rule.

41. 43 Cal. 2d 254, 273 P.2d 257 (1954).

42. *Id.* at 257, 273 P.2d at 258. "By his act of relinquishment Mr. Kesler sought to exercise control over his interest in the community cause of action and give up his rights in the recovery. The right to dispose of property, however, constitutes a major interest of the owner therein, and if by the exercise of such right the owner could avoid the effect of his contributory negligence and thus create an enforceable right in his donee that did not theretofore exist, he would in fact profit by his own wrong." *See* Ferguson v. Rogers, 168 Cal. App. 2d 486, 336 P.2d 234 (1959); Comment, 42 CALIF. L. REV. 838 (1954); 6 HASTINGS L.J. 88 (1954).

43. *See, e.g.,* Washington v. Washington, 47 Cal. 2d 249, 255, 302 P.2d 569, 572 (1956) where Justice Carter, concurring, wrote, "I am of the opinion now, as I have always been, that a cause of action for personal injuries is a separate and personal one and that the recovery therefor should be the separate property of the injured spouse except for the actual loss to the community in the earning power of the injured spouse. . . ."

44. Cal. A.B. 3286 (1957); Cal. S.B. 1826 (1957). *See* Brunn, *California Personal Injury Damage Awards to Married Persons,* 13 U.C.L.A.L. REV. 587 (1966) [hereinafter cited as Brunn].

action, even though the damages that are recovered are community property."[45] The failure of the legislature to pass this bill[46] led to the unfortunate result in *Rogers*. The other proposal was Senate Bill 1826 which became Civil Code section 163.5. It provided that "[a]ll damages, special and general, awarded a married person in a civil action for personal injuries, are the separate property of such married person."[47] Concurrently, Civil Code section 171(c) was amended to delete any reference to the community property nature of personal injury damages.[48]

Former section 163.5 had been recommended previously by a conference of state bar delegates.[49] The legislature, however, did not follow the model of the state bar resolution carefully. The resolution had provided that "damages for pain, suffering, disfigurement and . . . disability [would be the] separate property of the injured spouse."[50] Therefore, all other damages, such as for medical expenses and loss of earnings, apparently would remain community property.[51] The state bar proposal also included reference to both the cause of action and damages,[52] but former section 163.5 referred only to "damages . . . awarded." No mention was made of compromise settlements.[53] Because the statute did not attack the problem of imputed contributory negligence directly, it raised criticism.[54] The legislature's failure to follow the carefully drawn state bar proposal opened the door for erroneous and inconsistent application of the statute in cases where there was no problem of contributory negligence.

Undoubtedly, the legislature's intent in enacting former section 163.5 was to abolish the imputed contributory negligence rule which barred recovery by innocent spouses.[55] Indeed, the sponsor of the bill,

45. Cal. A.B. 3286 (1957). See Brunn, *supra* note 44, at 589.

46. 1957 CAL. ASSEMBLY FINAL HISTORY 1097; CAL. ASSEMBLY J. 6990 (1957). See Brunn, *supra* note 44, at 589.

47. Cal. Stat. 1957, ch. 2334, § 1 at 4065. See note 4 *supra* for history.

48. Cal. Stat. 1957, ch. 2334, § 2, at 4066 *amending* Cal. Stat. 1951, ch. 1102, § 1, at 2860.

49. Conference of Cal. State Bar Delegates, *Action on Conference Resolutions*, 30 CAL. ST. B.J. 499 (1955).

50. *Id.*

51. *See* 4 B. WITKIN, SUMMARY OF CALIFORNIA LAW 2713 (7th ed. 1960).

52. Conference of Cal. State Bar Delegates, *Action on Conference Resolutions*, 30 CAL. ST. B.J. 499 (1955). *See* 4 B. WITKIN, SUMMARY OF CALIFORNIA LAW 2713 (7th ed. 1960).

53. See note 4 *supra.*

54. See notes 55 & 60 *infra.*

55. 4 B. WITKIN, SUMMARY OF CALIFORNIA LAW 2712 (7th ed. 1960) states that "[t]he injustice of the imputed negligence rule, and the inadequacy of prior judicial and legislative attempts to eliminate it, induced the 1957 Legislature to take the bold step of a complete change in the character of the property. . . .

Senator James A. Cobey, stated, "I might say that my intention was to outlaw the imputation of the contributory negligence of one spouse to the other . . . ."[56] However, the statute, as construed in *Rogers*, was broader than necessary to accomplish this purpose. In *Rogers*, there was never any question of contributory negligence.[57] By applying the statute in that situation, the court changed the nature of damages in *all* personal injury actions involving a married person.[58]

In addition to inducing erroneous application, section 163.5 failed to distinguish the various interests which damages reimburse. "[A]ll damages, *special and general* . . ." were the separate property of the injured spouse.[59] There was no provision for reimbursement to the community for medical expenses paid from community funds or for compensating the community for the loss of future earnings. The statute, in effect, forced the injured spouse to treat as separate property interests such as earnings, which are ordinarily community property.[60]

Award Versus Compromise Settlement

The legislative purpose for former section 163.5[61] and the unfortunate result reached in *Rogers* necessitate that an award be distinguished from a settlement when contributory negligence is not involved. This distinction is neither contrary to a literal construction of the section nor general community property principles. "It has long been held in California that both the *cause of action* and the *damages recovered* for personal injuries to either husband or wife are community property . . . ."[62] However, former Civil Code section 163.5

Although the new statute [former Civil Code section 163.5] completely solves the imputed negligence problem, it raises other serious problems. . . ." *See* Self v. Self, 58 Cal. 2d 683, 691, 376 P.2d 65, 70, 26 Cal. Rptr. 97, 102 (1962); 1 CALIFORNIA FAMILY LAWYER 113 (Cal. Cont. Educ. Bar 1961); Committee on Continuing Education of the Bar, *Selected 1957 Code Legislation*, 32 CAL. ST. B.J. 501, 508 (1957).

56. Letter from Senator Cobey to Mr. Ralph N. Kleps, Legislative Council, Sacramento in Comment, *Civil Code Section 163.5: Solution or Enigma?*, 9 HASTINGS L.J. 291, 295 n.23 (1958).

57. See text accompanying note 9 *supra*.

58. Note, 45 CALIF. L. REV. 779, 782 (1957).

59. Cal. Stat. 1957, ch. 2334, § 1, at 4065 (emphasis added). See note 4 *supra* for history.

60. 1 CALIFORNIA FAMILY LAWYER 113 (Cal. Cont. Educ. Bar 1961) states: "Undoubtedly, this legislation arose from dissatisfaction with the imputed negligence doctrine, and not from any real desire to permit the husband, for example, to give away without the consent of his wife or to will to a third party money awarded to him for the loss of his earning power for the rest of his life, which was a community asset; that nevertheless will be the effect of the statute."

61. See text accompanying note 56 *supra*.

62. 4 B. WITKIN, SUMMARY OF CALIFORNIA LAW 2710 (7th ed. 1960), *citing* Zaragosa v. Craven, 33 Cal. 2d 315, 202 P.2d 73 (1949); Sanderson v. Niemann,

refers only to "damages . . . awarded . . . in a civil action."[63] A literal reading excludes the cause of action. The statute is also silent concerning recoveries by compromise settlement. Because of this silence and traditional community property law, legal writers disagreed on whether a settlement would be held to be separate or community property.[64] Arguably, by definition an award is not the same as a settlement. This is consistent with the definition provided by one court, "[t]o award is to adjudge, to give or assign by sentence or judicial determination."[65] A settlement is an agreement between the parties to a cause of action, not an award made by a court. Thus, a settlement can be treated as community property under former section 163.5.

There are few cases dealing with the distinction between an award and a settlement in the personal injury context. One of these, *Estate of Simoni*,[66] involved an award by the Industrial Accident Commission. The court stated that prior to the enactment of section 163.5, compensation payable under the Workmen's Compensation Insurance and Safety Act was community property.[67] The court continued:

> It does not appear that the Legislature intended . . . to change the character of such an award. If such a change had been contemplated . . . [it] would have [been] expressly so stated.
>
> The award by the Industrial Accident Commission was not an award of damages in a civil action within the meaning of section 163.5 of the Civil Code.[68]

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17 Cal. 2d 563, 110 P.2d 1025 (1941); Giorgetti v. Wollaston, 83 Cal. App. 358, 257 P. 109 (1927).

63. Cal. Stat. 1957, ch. 2334, § 1, at 4065 (amended 1968, repealed 1969). See note 4 *supra*.

64. 1 CALIFORNIA FAMILY LAWYER 113 (Cal. Cont. Educ. Bar 1961) states that "[t]he statute does not mention the cause of action itself or amounts received in compromise of such actions, but it would seem that the intention was probably to make those separate also." See Comment, *Civil Code Section 163.5: Solution or Enigma?*, 9 HASTINGS L.J. 291, 304-05 (1958). A contrary view is expressed by a writer who takes the language of the statute literally and concludes that "it seems quite likely that the property nature of any recovery by way of settlement is not affected." Note, 45 CALIF. L. REV. 779, 780 n.2 (1957). *See* Committee on Continuing Education of the Bar, *Selected 1957 Code Legislation*, 32 CAL. ST. B.J. 501, 508 (1957). Still another commentator expresses the view that "[f]rom a practical standpoint, there would appear to be no justification for treating settlements differently from judgments." Brunn, *supra* note 44, at 597.

65. Hobson v. Superior Court, 69 Cal. App. 60, 66, 230 P. 456, 458 (1924).

66. 220 Cal. App. 2d 339, 33 Cal. Rptr. 845 (1963).

67. *Id.* at 344, 33 Cal. Rptr. at 849.

68. *Id.* It is conceded, however, that in workmen's compensation cases contributory negligence is not a defense as a matter of law and therefore these awards are distinguishable from those received in a civil action. In *Rogers* there was no contributory negligence as a matter of fact. See note 9 *supra*.

In *Blankenship v. Blankenship*,[69] the question of the characterization of a compromise settlement was squarely presented. The court, however, did not find it necessary to decide the issue. On appeal Mr. Blankenship did not pursue his argument that a personal injury settlement was separate property. Interestingly, however, "[t]he [trial] court found the settlement proceeds and the truck and trailer [bought with the proceeds] were the community property of the parties . . . ."[70]

Despite this lack of case law, a strong argument for distinguishing between awards and compromise settlements can be made. This argument is based on the legislative purpose of former Civil Code section 163.5.[71] The problem of imputed contributory negligence simply does not arise when a case is settled. Furthermore, the statue does not speak of settlements. In fact, the legislature did not follow the format suggested by the state bar committee. That suggestion included compromise settlements.[72] Unless the statute is strictly construed, as it was in *Estate of Simoni*,[73] its application to settlements goes beyond the legislative intent. Thus, the *Rogers* court exceeded community property principles and departed from the statute's purpose in applying former section 163.5.

The Tax Consequences of Former Civil Code Section 163.5

The result in *Rogers* is due to the unfavorable gift and inheritance tax[74] consequences that arose when Mr. and Mrs. Rogers treated his separate property as community property. Even if personal injury recoveries are characterized as separate property, that property can be converted to community property by consent of the spouses.[75] Indeed, this is what the Rogers actually did. The California Law Revision Commission elucidated the resulting tax problems quite succinctly:

> Some couples may, by commingling a damages award with community property, convert it to community property and inad-

69. 212 Cal. App. 2d 736, 28 Cal. Rptr. 176 (1963).

70. *Id.* at 748, 28 Cal. Rptr. at 184.

71. See text accompanying note 56 *supra.*

72. See text accompanying note 49 *supra.*

73. 220 Cal. App. 2d 339, 33 Cal. Rptr. 845 (1963). See text accompanying notes 66-68 *supra.*

74. Gift and inheritance taxes are excise taxes. A gift tax is one that is levied on the privilege of *inter vivos* transfer of property made with a donative intent from donor to donee. *See* CAL. REV. & TAX CODE § 15104 (West 1970). On the other hand, "California inheritance tax is imposed on the right or privilege to succeed to or take property from a decedent. It is a succession tax [on the property] charged to the beneficiaries of the decedent's property rather than a tax on the property itself." 1 CALIFORNIA DECEDENT ESTATE ADMINISTRATION 562 (Cal. Cont. Educ. Bar 1971). Gift and inheritance taxes then are taxes on two distinct property interests.

75. *See* Zaragosa v. Craven, 33 Cal. 2d 315, 321, 202 P.2d 73, 77 (1949); Tomaier v. Tomaier, 23 Cal. 2d 754, 757-58, 146 P.2d 905, 907 (1944).

> vertently incur a gift tax liability upon which penalties and interest may accrue for years before they realize that the liability exists.
>
> Upon the death of the injured spouse, the damages awarded for personal injuries are subject to an inheritance tax even though they are inherited by the surviving spouse, while other community property goes to the surviving spouse tax free.[76]

The legislature in enacting former Civil Code section 163.5 did not intend to create a class of property which would be subject to taxes in this way. However, this is precisely what resulted from *Rogers'* application of former Civil Code section 163.5 and Revenue and Taxation Code section 13560.

Legislative Intent of Revenue and Taxation Code Section 13560

The taxation of the settlement in *Rogers* arose from the interaction of the erroneous application of section 163.5 and Revenue and Taxation Code section 13560. The application of the latter provision also was contrary to the purpose of that section. In 1965, the legislature undertook to revise the laws dealing with gift and inheritance taxes. Revenue and Taxation Code section 15301[77] was amended to allow gift tax-free transfers of community property between spouses.[78] Thus, the gift tax treatment of community property became consistent with that of the inheritance tax under section 13551.[79] These two statutes provided a "completely tax-free, inter-spousal rule for community property gifts."[80] A state bar committee saw a possible loophole. Some tax liabilities could be avoided by a two-step conversion of "separate property [first] to community property and . . . then . . . to the separate property of the other spouse by gift."[81] Under this process, gift tax would be paid on one-half of the separate property that was converted to community property. Then, because

76. 8 CALIFORNIA LAW REVISION COMM'N, REPORTS, RECOMMENDATIONS & STUDIES, 407, 408 (1967).

77. CAL. REV. & TAX CODE § 15301 (West 1970) provides that "[i]n the case of a transfer to either spouse by the other of community property, none of the property transferred is subject to this part [gift tax]."

78. CAL. REV. & TAX CODE § 15301 (West 1970) *amending* Cal. Stat. 1965, ch. 1070, § 8, at 2720. See note 81 *infra.*

79. *See* CAL. REV. & TAX CODE § 13551 (West 1970) which states that "[u]pon the death of a spouse: (a) None of the community property transferred to a spouse is subject to this part [inheritance tax], except as provided in Section 13694 [power of appointment]."

80. Martin & Miller, *Estate Planning and Equal Rights,* 40 CAL. ST. B.J. 706, 710 (1965).

81. *Id. See generally* Committee on Taxation, *Report,* 39 CAL. ST. B.J. 560, 575-78 (1964). Cal. Stat. 1943, ch. 658, § 1, at 2337 (repealed 1965) previously had taken care of this problem by imposing a gift tax at the donor's death. This was thought to be an incongruous way to handle the problem and repeal of this section was recommended. Committee on Taxation, *Report,* 39 CAL. ST. B.J. 560, 564 (1964).

Revenue and Taxation Code section 15301[82] provided for tax-free gifts of community property between spouses, the other one-half would escape tax completely when it was transferred to the separate property of the other spouse.

Revenue and Taxation Code section 13560 was recommended by the committee.[83] It provides that *for tax purposes*, community property that had its origin in the separate property of one spouse, shall be treated as separate property and not community property.[84] Therefore, it is clear that the legislature's intent in enacting Revenue and Taxation Code section 13560 was to prevent tax avoidance through a two-step conversion of separate property.[85] The application of this tax provision to the facts of *Rogers* therefore is not in accord with the legislature's intent. Additionally, this application raises serious constitutional questions.

Constitutional Considerations of Revenue and Taxation Code Section 13560

The state has wide discretion to classify property for taxation purposes and to tax transfers by gift or inheritance:

> In the field of taxation the Legislature has wide discretion to classify. As the United States Supreme Court said with reference to the California inheritance tax: "But we do not find it necessary to discuss the issue thus raised, for it has been repeatedly held by this court that the power of testamentary disposition and the privilege of inheritance are subject to state taxation and state regulation, and that regulatory taxing provisions, even though they produce inequalities in taxation, do not affect an unconstitutional taking of property. . . ."[86]

This broad power may be a barrier to a constitutional attack on the application of Revenue and Taxation Code section 13560 in the *Rogers* case. However, the legislature must act within constitutional limitations and the legislation must provide that,

> all persons subjected to such legislation within the classification are treated with equality and . . . that the classification itself be rested

82. See note 79 *supra*. CAL. REV. & TAX CODE § 13551 (West 1970) provides for inheritance tax free transfer of community property from decedent to surviving spouse.

83. *See* Committee on Taxation, *Report*, 39 CAL. ST. B.J. 560, 568 (1964).

84. CAL. REV. & TAX CODE § 13560 (West 1970); *id.* § 15310 (West 1970). See note 8 *supra*.

85. Committee on Taxation, *Report*, 39 CAL. ST. B.J. 560, 578 (1964). "The enactment of these new sections would, in effect, confine the exemption from gift tax of inter-spouse transfers of community property to community property which was such from the moment of acquisition by either spouse, or which was created by agreement from property acquired by gift from others, or which was created by agreement following a purchase by one spouse of an interest in the other's separate property."

86. Estate of Rogers, 245 Cal. App. 2d 101, 104, 53 Cal. Rptr. 572, 574 (1966).

> upon some ground of difference having a fair and substantial relation to the object of the legislation.[87]

In other words, the classification must not be arbitrary nor discriminatory.

Mrs. Rogers belongs to a class of persons who receive community property by transfer at the death of a spouse. Most other members of this class receive their community property tax free. It is true that Mrs. Rogers also may belong to a sub-class, which includes spouses whose predeceased spouses received a personal injury settlement. In either event, the question is whether the classification is reasonable and bears substantial relation to the purpose of the statute. If not, equal protection is possibly denied.

There are two apparent bases upon which the classification of spouses standing in the position of Mrs. Rogers can be questioned. First, the nature of personal injury recoveries makes them actually more analogous to income than gifts. Damages include medical expenses and compensation for the loss of future earnings. These are clearly community in nature.[88] In addition, pain and suffering are a detriment to the community; when one spouse is injured, that spouse suffers, but so, too, does the marital community.[89] The burden on the non-injured spouse is clearly demonstrated in *Rogers*.[90] Given the extent to which the *community* is damaged, the classification of damages as separate property hardly can be deemed reasonable.

Secondly, even assuming that the compromise settlement in *Rogers* was correctly classified as separate property, it became community property for all purposes other than taxation.[91] This was because Mr. and Mrs. Rogers treated the settlement as community property. It was subject to the same rules of management and control and disposition by will, gift or succession as community property obtained in other ways.[92] When the property was transmuted and the gift tax liability incurred, Mrs. Rogers gained a vested interest in that *community* property.[93] To apply Revenue and Taxation Code section 13560 to this type of community property is not a rational distinction.

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87. *Id.* at 105, 53 Cal. Rptr. at 575.

88. Considering the fact that some personal injury damages are compensation for interests that traditionally have been considered community in nature, as a practical matter, it makes no difference whether the damages are received by award or compromise. However, to then classify these damages as separate property defeats the very purpose of compensation for the community injury.

89. *See* Deshotel v. Atchison T. & S.F. Ry. Co., 50 Cal. 2d 664, 669, 328 P.2d 449, 452 (1958) (Carter, J., dissenting).

90. See notes 9 & 12 *supra.*

91. *See* CAL. CIV. CODE § 5103 (West 1970). *See* Bank of America Nat. Trust & Sav. Ass'n v. Rogan, 33 F. Supp. 183 (S.D. Cal. 1940).

92. *See* CAL. CIV. CODE § 5103 (West 1970).

93. This could be accomplished under Revenue and Taxation Code section 13551. See note 79 *supra.*

Considering the nature of personal injury recoveries[94] and the treatment given the settlement by the Rogers,[95] the classification in *Rogers* is unreasonable. In addition to being unreasonable, the classification does not bear a fair and substantial relationship to the object of the legislation. When the legislative purposes for both former Civil Code section 163.5 and Revenue and Taxation Code section 13560 are read together, personal injury recoveries should not be taxed under the latter section. Former section 163.5 was enacted to abrogate the imputed contributory negligence rule[96] Revenue and Taxation Code section 13560 was adopted to prevent tax avoidance by one spouse transferring separate property to the marital community and then from the community to the separate property of the other spouse.[97] As has been discussed,[98] neither of these problems confronted the court in *Rogers*. Thus, the classification of personal injury recoveries, whether from awards or settlements, as separate property for the purposes of taxation is arbitrary and discriminatory, having no fair and substantial relation to the object of the legislation. "Equality of burden is a fundamental principle of taxation. Equal protection demands that similar property be taxed by the same yardstick to those similarly situated."[99] Mrs. Rogers is denied equal protection because her community property is taxed differently from that of other spouses whose predeceased spouses have recovered damages for personal injuries.

Rationale for Relief from Tax Burden

The 1968 Amendment of Former Civil Code Section 163.5

A 1968 amendment was motivated by frank recognition of the problems generated by former section 163.5. This amendment attacked the rule of imputed contributory negligence directly. The California Law Revision Commission in 1967 had stated:

> To eliminate . . . [the] undesirable ramifications of Section 163.5, the Commission recommends the enactment of legislation that would again make personal injury damages awarded to a married person community property. The problem of imputed contributory negligence should be met in some less drastic way than by converting all such damages into separate property even where no contributory negligence is involved.
>
> Although personal injury damages awarded to a married person should be community property as a general rule, the Commission recommends retention of the rule that such damages are

94. See note 88 and accompanying text *supra*.
95. See note 13 and accompanying text *supra*.
96. See text accompanying note 56 *supra*.
97. See note 85 and accompanying text *supra*.
98. See notes 9 & 85 and accompanying text *supra*.
99. Estate of Legatos, 1 Cal. App. 3d 657, 661, 81 Cal. Rptr. 910, 913 (1969).

> separate property when they are paid in compensation for an injury inflicted by the other spouse.[100]

In 1968, the legislature amended former Civil Code section 163.5[101] to comply with the recommendation of the Law Revision Commission. To prevent the rule of imputed contributory negligence from being applied again, the legislature simultaneously enacted former Civil Code section 164.6 which provided that the contributory negligence of the spouse was not a defense in any action brought by the injured person except where it would be a defense if no marriage existed.[102]

Thus, damages for personal injuries are again community property. However, under the *Rogers* decision, Californians, who received personal injury damages by settlement during the time that former Civil Code section 163.5 was in effect, are left to pay the penalty for the earlier piecemeal, ambiguous legislation. For the period between 1957 and 1968, an unequal burden of taxation is placed on that class of spouses who received personal injury damages. This is unjust.

The policy behind community property is that of equality between husband and wife and the contributions each makes to the marital community.[103] When a spouse is injured, the community is damaged.[104] However, when the damages are characterized as the separate property of the injured spouse, the marital community is not compensated.[105] Furthermore, given the legislative intent of both former Civil Code section 163.5[106] and Revenue and Taxation Code section 13560[107] and the resulting constitutional problems, judicial or legislative remedies must be provided.

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100. 8 CALIFORNIA LAW REVISION COMM'N, REPORTS, RECOMMENDATIONS & STUDIES, 407, 408-09 (1967).

101. Cal. Stat. 1968, ch. 457, § 2, at 1078 (repealed 1969).

102. Cal. Stat. 1968, ch. 457, § 3, at 1078. This was incorporated into the Family Law Act of 1970 by Cal. Stat. 1969, ch. 1608, § 8, at 3339 and is now CAL. CIV. CODE § 5112 (West 1970). The statute states that "[i]f a married person is injured by the negligent or wrongful act or omission of a person other than his spouse, the fact that the negligent or wrongful act or omission of the spouse of the injured person was a concurring cause of the injury is not a defense in any action brought by the injured person to recover damages for such injury except in cases where such concurring negligent or wrongful act or omission would be a defense if the marriage did not exist."

103. W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 24 (2d ed. 1971).

104. Some writers suggest that there are really two causes of action arising from the same accident. One is in the injured spouse for pain and suffering and should be the separate property of that spouse. The other is in the marital community for medical expenses and compensation for loss of future earnings. See W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 202-05 (2d ed. 1971); Brunn, *supra* note 44, at 557.

105. See text accompanying note 59 & 60 *supra.*

106. See text accompanying note 56 *supra.*

107. See text at note 83-85 *supra.*

Relief from Revenue and Taxation Code Section 13560

Relief from the tax burden of Revenue and Taxation Code section 13560 as applied to "damages . . . awarded" should be granted. Complete relief will be afforded if the legislature makes both awards and compromise settlements community property for the purposes of taxation. This can be accomplished by amending Revenue and Taxation Code section 13560 so that it does not apply to personal injury damages recovered while former Civil Code section 163.5, as it read in 1957,[108] was in effect. This will afford complete relief. The relief will be reconcilable with former section 163.5. Even though that statute provides that "awards . . . granted" are to be the separate property of the injured spouse, its sole purpose was to abrogate the rigors of imputed contributory negligence. The courts can provide this solution and avoid the possible constitutional conflict without nullifying the legislative purpose of either former section 163.5 or Revenue and Taxation Code section 13560.[109]

Assuming a reluctance to provide the complete relief described above, equitable relief can be given to those in the position of Mrs. Rogers by strictly construing former section 163.5. The courts can find that settlements are not the same as "awards . . . granted" within the meaning of former Civil Code section 163.5. Therefore, settlements would be community property. While this may be regarded as a technical distinction, it is not repugnant to the legislature's intent. Indeed, in order to avoid the harsh results of *Rogers*, the legislature itself has corrected the ambiguities inherent in the statute.[110]

Conclusion

The characterization of compromise settlements as separate property and the attendant tax consequences will have wide impact. In the ten years that former Civil Code section 163.5 was in effect, probably thousands of personal injury cases were settled. Since *Rogers* is the first case to apply former section 163.5 to compromise settlements, many spouses will have treated these settlements as community property. In all likelihood most people treat settlements as community property because medical expenses and compensation for loss of earn-

108. Cal. Stat. 1957, ch. 2334, § 1, at 4065 (amended 1968, repealed 1969). See note 4 *supra*.

109. *Rogers* is the first case to construe former Civil Code section 163.5 as applying to "compromise settlements" and also the first case to construe Revenue and Taxation Code section 13560. It is true that the Supreme Court of California refused to hear the case, but this does not necessarily imply approval of the court of appeals decision. *See generally* Kanner, *It's a Busy Court: The Effect of Denial of Hearing by the Supreme Court on Court of Appeals Decisions*, 47 CAL. ST. B.J. 188 (1972).

110. See text accompanying notes 88-94 *supra*.

ings are contained in the lump sum. This practical fact makes the holding of *Rogers* so inequitable. Under the *Rogers* decision, spouses who have treated settlements as community property will incur gift tax liability plus penalty and interest. They will also be subject to inheritance tax. In light of the law prior to 1957 and after 1968, the treatment of personal injury recoveries from settlements in this manner creates an unjust situation. This injustice is especially acute because the statutory language was so ambiguous.

These factors point out the harshness of the *Rogers* result. Additionally, classification of personal injury recoveries as separate property for the purposes of taxation is irrational and bears no fair and substantial relation to the object of the legislation. This classification is not necessary to give effect to the purpose of former California Civil Code section 163.5. Likewise, Revenue and Taxation Code section 13560 need not be applied to cases such as *Rogers* in order to fulfill the legislature's intent. Indeed, if Revenue and Taxation Code section 13560 is applied in such situations, serious constitutional questions are raised.

This note has suggested solutions which will alleviate the hardships and constitutional questions raised by the *Rogers* decision. These proposals would prevent the application of Revenue and Taxation Code section 13560 to similar situations. Once the unfair tax consequences are eliminated, the hydra-headed monster of imputed contributory negligence finally will be laid to rest.

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